SENATE BILL 3158

By Burchett

AN ACT to amend Tennessee Code Annotated, Title 67, relative to taxation.

BE IT ENACTED BY THE GENERAL ASSEMBLY OF THE STATE OF TENNESSEE:

SECTION 1. Tennessee Code Annotated, Title 67, Chapter 4, Part 20, is amended by adding the following language as a new, appropriately numbered section:

§ 67-4-20__.

(a) As used in this section, unless the context otherwise requires:

(1) “Combined group” means the group of all persons whose income and apportionment factors are required to be taken into account pursuant to subdivisions (b)(1) or (2) in determining the taxpayer’s share of the net business income or loss apportionable to this state;

(2) “Corporation” means any corporation as defined by the laws of this state or organization of any kind treated as a corporation for tax purposes under the laws of this state, wherever located, which if it were doing business in this state would be a taxpayer. The business conducted by a partnership which is directly or indirectly held by a corporation shall be considered the business of the corporation to the extent of the corporation’s distributive share of the partnership income, inclusive of guaranteed payments to the extent prescribed by regulation;

(3) "Partnership" means a general or limited partnership, or organization of any kind treated as a partnership for tax purposes under the laws of this state;

(4) "NOL" means net operating loss;

(5) "OECD" means the Organization for Economic Co-operation and Development;

(6) “Tax haven” means a jurisdiction that, during the tax year in question:

(A) Is identified by the OECD as a tax haven or as having a harmful preferential tax regime, or

(B) Exhibits the following characteristics established by the OECD in its 1998 report entitled Harmful Tax Competition: An Emerging Global Issue as indicative of a tax haven or as a jurisdiction having a harmful preferential tax regime, regardless of whether it is listed by the OECD as an un-cooperative tax haven:

(i) Has no or nominal effective tax on the relevant income; and

(ii)

(*a*) Has laws or practices that prevent effective exchange of information for tax purposes with other governments on taxpayers benefiting from the tax regime;

(*b*) Has a tax regime which lacks transparency. A tax regime lacks transparency if the details of legislative, legal or administrative provisions are not open and apparent or are not consistently applied among similarly situated taxpayers, or if the information needed by tax authorities to determine a taxpayer's correct tax liability, such as accounting records and underlying documentation, is not adequately available;

(*c*) Facilitates the establishment of foreign-owned entities without the need for a local substantive presence or prohibits these entities from having any commercial impact on the local economy;

(*d*) Explicitly or implicitly excludes the jurisdiction's resident taxpayers from taking advantage of the tax regime's benefits or prohibits enterprises that benefit from the regime from operating in the jurisdiction's domestic market; or

(*e*) Has created a tax regime which is favorable for tax avoidance, based upon an overall assessment of relevant factors, including whether the jurisdiction has a significant untaxed offshore financial or other services sector relative to its overall economy;

(7) "Unitary business" means a single economic enterprise that is made up either of separate parts of a single business entity or of a commonly controlled group of business entities that are sufficiently interdependent, integrated and interrelated through their activities so as to provide a synergy and mutual benefit that produces a sharing or exchange of value among them and a significant flow of value to the separate parts. Any business conducted by a partnership shall be treated as conducted by its partners, whether directly held or indirectly held through a series of partnerships, to the extent of the partner's distributive share of the partnership's income, regardless of the percentage of the partner's ownership interest or its distributive or any other share of partnership income. A business conducted directly or indirectly by one (1) corporation is unitary with that portion of a business conducted by another corporation through its direct or indirect interest in a partnership if the conditions of the first sentence of this subdivision are satisfied, to wit: there is a synergy, and exchange and flow of value between the two (2) parts of the business and the two (2) corporations are members of the same commonly controlled group; and

(8) “United States” means the fifty (50) states of the United States, the District of Columbia, and United State’s territories and possessions.

(b)

(1) A taxpayer engaged in a unitary business with one (1) or more other corporations shall file a combined report which includes the income, determined under subdivision (c)(3), and apportionment factors, determined under this part, part 21 of this chapter and subdivision (c)(2), of all corporations that are members of the unitary business, and such other information as required by the commissioner.

(2) The commissioner may, by regulation, require the combined report include the income and associated apportionment factors of any persons that are not included pursuant to subdivision (1), but that are members of a unitary business, in order to reflect proper apportionment of income of entire unitary businesses. Authority to require combination by regulation under this subdivision includes authority to require combination of persons that are not, or would not be if doing business in this state, subject to this part and part 21 of this chapter.

(3) In addition, if the commissioner determines that the reported income or loss of a taxpayer engaged in a unitary business with any person not included pursuant to subdivision (1) represents an avoidance or evasion of tax by such taxpayer, the commissioner may, on a case-by-case basis, require all or any part of the income and associated apportionment factors of such person be included in the taxpayer’s combined report.

(4) With respect to inclusion of associated apportionment factors pursuant to subdivision (3), the commissioner may require the exclusion of any one (1) or more of the factors, the inclusion of one (1) or more additional factors which will fairly represent the taxpayer's business activity in this state, or the employment of any other method to

effectuate a proper reflection of the total amount of income subject to apportionment and an equitable allocation and apportionment of the taxpayer's income.

(c)

(1)

(A) Each taxpayer member is responsible for tax based on its income or loss apportioned or allocated to this state, which shall include:

(i) Its share of any business income apportionable to this state of each of the combined groups of which it is a member, determined under subdivision (2);

(ii) Its share of any business income approportionable to this state of a distinct business activity conducted within and without the state wholly by the taxpayer member, as business earnings are allocated and apportioned pursuant to this part and part 21 of this chapter;

(iii) Its income from a business conducted wholly by the taxpayer member entirely within the state,

(iv) Its income sourced to this state from the sale or exchange of capital or assets, and from involuntary conversions, as determined under subdivision (3)(B)(vii) ;

(v) Its nonbusiness income or loss allocable to this state, determined under as business earnings are allocated and apportioned pursuant to this part and part 21 of this chapter;

(vi) Its income or loss allocated or apportioned in an earlier year, required to be taken into account as state source income during the income year, other than a net operating loss, and

(vii) Its net operating loss carryover or carryback. If the taxable income computed pursuant to this subsection results in a loss for a taxpayer member of the combined group, that taxpayer member has a Tennessee NOL, subject to the net operating loss limitations, carryforward and carryback provisions of this part and part 21 of this chapter. Such NOL is applied as a deduction in a prior or subsequent year only if that taxpayer has Tennessee source positive net income, whether or not the taxpayer is or was a member of a combined reporting group in the prior or subsequent year.

(B) Except where otherwise provided, no tax credit or post-apportionment deduction earned by one (1) member of the group, but not fully used by or allowed to that member, may be used in whole or in part by another member of the group or applied in whole or in part against the total income of the combined group; and a post-apportionment deduction carried over into a subsequent year as to the member that incurred it, and available as a deduction to that member in a subsequent year, will be considered in the computation of the income of that member in the subsequent year, regardless of the composition of that income as apportioned, allocated or wholly within this state.

(2) The taxpayer's share of the business income apportionable to this state of each combined group of which it is a member shall be the product of:

(A) The business income of the combined group, determined under subdivision (3), and

(B) The taxpayer member's apportionment percentage, determined under § 67-4-2012 including in the property, payroll and receipt factor numerators the taxpayer's property, payroll and receipts, respectively, associated with the

combined group's unitary business in this state, and including in the denominator the property, payroll and receipts of all members of the combined group, including the taxpayer, which property, payroll and receipts are associated with the combined group's unitary business wherever located. The property, payroll, and receipts of a partnership shall be included in the determination of the partner's apportionment percentage in proportion to a ratio the numerator of which is the amount of the partner's distributive share of partnership's unitary income included in the income of the combined group in accordance with subdivision (3)(B)(iii) and the denominator of which is the amount of the partnership's total unitary income.

(3) The business income of a combined group is determined as follows:

(A) From the total business income of the combined group, determined under subdivision (3)(B) subtract any business income, and add any expense or loss, other than the business income, expense or loss of the combined group.

(B) Except as otherwise provided, the total business income of the combined group is the sum of the business income of each member of the combined group determined under federal income tax laws, as if the member were not consolidated for federal purposes. The income of each member of the combined group shall be determined as follows:

(i) For any member incorporated in the United States, or included in a consolidated federal corporate income tax return, the income to be included in the total income of the combined group shall be the taxable income for the corporation after making appropriate adjustments under this part and part 21 of this chapter.

(ii)

(*a*) For any member not included in subdivision (3)(B)(i), the income to be included in the total income of the combined group shall be determined as follows:

(*1*) A profit and loss statement shall be prepared for each foreign branch or corporation in the currency in which the books of account of the branch or corporation are regularly maintained.

(*2*) Adjustments shall be made to the profit and loss statement to conform it to the accounting principles generally accepted in the United States for the preparation of such statements except as modified by this regulation.

(*3*) Adjustments shall be made to the profit and loss statement to conform it to the tax accounting standards required by the title 67.

(*4*) Except as otherwise provided by regulation, the profit and loss statement of each member of the combined group, and the apportionment factors related thereto, whether United States or foreign, shall be translated into the currency in which the parent company maintains its books and records.

(*5*) Income apportioned to this state shall be expressed in United States dollars.

(*b*) In lieu of the procedures set forth in subdivision (3)(B)(ii)(*a*), above, and subject to the determination of the commissioner that it reasonably approximates business income as

determined under this part and part 21 of this chapter, any member not included in subdivision (3)(B)(i) may determine its income on the basis of the consolidated profit and loss statement which includes the member and which is prepared for filing with the Securities and Exchange Commission by related corporations. If the member is not required to file with the Securities and Exchange Commission, the commissioner may allow the use of the consolidated profit and loss statement prepared for reporting to shareholders and subject to review by an independent auditor. If above statements do not reasonably approximate income as determined under this part and part 21 of this chapter the commissioner may accept those statements with appropriate adjustments to approximate that income.

(iii) If a unitary business includes income from a partnership, the income to be included in the total income of the combined group shall be the member of the combined group's direct and indirect distributive share of the partnership's unitary business income.

(iv) All dividends paid by one to another of the members of the combined group shall, to the extent those dividends are paid out of the income and profits of the unitary business included in the combined report, in the current or an earlier year, be eliminated from the income of the recipient. This provision shall not apply to dividends received from members of the unitary business which are not a part of the combined group.

(v) Except as otherwise provided by regulation, business income from an intercompany transaction between members of the same combined group shall be deferred in a manner similar to 26 CFR 1.1502-13. Upon the occurrence of any of the following events, deferred business income resulting from an intercompany transaction between members of a combined group shall be restored to the income of the seller, and shall be apportioned as business income earned immediately before the event:

(*a*) The object of a deferred intercompany transaction is

(*1*) Re-sold by the buyer to an entity that is not a member of the combined group,

(*2*) Re-sold by the buyer to an entity that is a member of the combined group for use outside the unitary business in which the buyer and seller are engaged, or

(*3*) Converted by the buyer to a use outside the unitary business in which the buyer and seller are engaged, or

(*b*) The buyer and seller are no longer members of the same combined group, regardless of whether the members remain unitary.

(vi) A charitable expense incurred by a member of a combined group shall, to the extent allowable as a deduction pursuant to Internal Revenue Code Section 170, be subtracted first from the business income of the combined group (subject to the income limitations of that section applied to the entire business income of the group), and any remaining amount shall then be treated as a nonbusiness expense allocable to the

member that incurred the expense (subject to the income limitations of that section applied to the nonbusiness income of that specific member). Any charitable deduction disallowed under the foregoing rule, but allowed as a carryover deduction in a subsequent year, shall be treated as originally incurred in the subsequent year by the same member, and the rules of this section shall apply in the subsequent year in determining the allowable deduction in that year.

(vii) Gain or loss from the sale or exchange of capital assets, property described by Internal Revenue Code Section 1231(a)(3), and property subject to an involuntary conversion, shall be removed from the total separate net income of each member of a combined group and shall be apportioned and allocated as follows.

(*a*) For each class of gain or loss (short term capital, long term capital, Internal Revenue Code Section 1231, and involuntary conversions) all members' business gain and loss for the class shall be combined (without netting between such classes), and each class of net business gain or loss separately apportioned to each member using the member's apportionment percentage determined under subdivision (2), above.

(*b*) Each taxpayer member shall then net its apportioned business gain or loss for all classes, including any such apportioned business gain and loss from other combined groups, against the taxpayer member's nonbusiness gain and loss for all classes allocated to this state, using the rules of Internal Revenue Code Sections 1231 and 1222, without regard to any of the

taxpayer member's gains or losses from the sale or exchange of capital assets, Section 1231 property, and involuntary conversions which are nonbusiness items allocated to another state.

(*c*) Any resulting state source income (or loss, if the loss is not subject to the limitations of Internal Revenue Code Section 1211) of a taxpayer member produced by the application of the preceding subsections shall then be applied to all other state source income or loss of that member.

(*d*) Any resulting state source loss of a member that is subject to the limitations of Section 1211 shall be carried forward (or carried back) by that member, and shall be treated as state source short-term capital loss incurred by that member for the year for which the carryover (or carryback) applies.

(vii) Any expense of one (1) member of the unitary group which is directly or indirectly attributable to the nonbusiness or exempt income of another member of the unitary group shall be allocated to that other member as corresponding nonbusiness or exempt expense, as appropriate.

(d)

As a filing convenience, and without changing the respective liability of the group members, members of a combined reporting group may annually elect to designate one taxpayer member of the combined group to file a single return in the form and manner prescribed by the department, in lieu of filing their own respective returns, provided that the taxpayer designated to file the single return consents to act as surety with respect to the tax liability of all other taxpayers properly included in the combined report, and

agrees to act as agent on behalf of those taxpayers for the year of the election for tax matters relating to the combined report for that year. If for any reason the surety is unwilling or unable to perform its responsibilities, tax liability may be assessed against the taxpayer members.

(e)

(1) Taxpayer members of a unitary group that meet the requirements of subdivision (2) may elect to determine each of their apportioned shares of the net business income or loss of the combined group pursuant to a water's-edge election. Under such election, taxpayer members shall take into account all or a portion of the income and apportionment factors of only the following members otherwise included in the combined group pursuant to subsection (b), as described below:

(A) The entire income and apportionment factors of any member incorporated in the United States or formed under the laws of any state, the District of Columbia, or any territory or possession of the United States;

(B) The entire income and apportionment factors of any member, regardless of the place incorporated or formed, if the average of its property, payroll, and receipts factors within the United States is twenty percent (20%) or more;

(C) The entire income and apportionment factors of any member which is a domestic international sales corporation as described in Internal Revenue Code Sections 991 to 994, inclusive; a foreign sales corporation as described in Internal Revenue Code Sections 921 to 927, inclusive; or any member which is an export trade corporation, as described in Internal Revenue Code Sections 970 to 971, inclusive;

(D) Any member not described in subdivisions (1)(A) to (1)(C), inclusive, shall include the portion of its income derived from or attributable to sources within the United States, as determined under the Internal Revenue Code without regard to federal treaties, and its apportionment factors related thereto;

(E) Any member that is a "controlled foreign corporation," as defined in Internal Revenue Code Section 957, to the extent of the income of that member that is defined in Section 952 of Subpart F of the Internal Revenue Code ("Subpart F income") not excluding lower-tier subsidiaries' distributions of such income which were previously taxed, determined without regard to federal treaties, and the apportionment factors related to that income; any item of income received by a controlled foreign corporation shall be excluded if such income was subject to an effective rate of income tax imposed by a foreign country greater than ninety percent (90%) of the maximum rate of tax specified in Internal Revenue Code Section 11;

(F) Any member that earns more than twenty percent (20%) of its income, directly or indirectly, from intangible property or service related activities that are deductible against the business income of other members of the combined group, to the extent of that income and the apportionment factors related thereto; and

(G) The entire income and apportionment factors of any member that is doing business in a tax haven, where "doing business in a tax haven" is defined as being engaged in activity sufficient for that tax haven jurisdiction to impose a tax under United States constitutional standards. If the member's business activity within a tax haven is entirely outside the scope of the laws, provisions and practices that cause the jurisdiction to meet the criteria established in

subdivision (a)(6), the activity of the member shall be treated as not having been conducted in a tax haven.

(2)

(A) A water's-edge election is effective only if made on a timely-filed, original return for a tax year by every member of the unitary business subject to tax under this part and part 21 of this chapter. The commissioner shall develop rules and regulations governing the impact, if any, on the scope or application of a water's-edge election, including termination or deemed election, resulting from a change in the composition of the unitary group, the combined group, the taxpayer members, and any other similar change.

(B) Such election shall constitute consent to the reasonable production of documents and taking of depositions.

(C) In the discretion of the commissioner, a water's-edge election may be disregarded in part or in whole, and the income and apportionment factors of any member of the taxpayer's unitary group may be included in the combined report without regard to the provisions of this section, if any member of the unitary group fails to comply with any provision of this act or if a person otherwise not included in the water's-edge combined group was availed of with a substantial objective of avoiding state income tax.

(D) A water's-edge election is binding for and applicable to the tax year it is made and all tax years thereafter for a period of ten (10) years. It may be withdrawn or reinstituted after withdrawal, prior to the expiration of the ten-year period, only upon written request for reasonable cause based on extraordinary hardship due to unforeseen changes in state tax statutes, law, or policy, and only with the written permission of the commissioner. If the commissioner grants a

withdrawal of election, he or she shall impose reasonable conditions as necessary to prevent the evasion of tax or to clearly reflect income for the election period prior to or after the withdrawal. Upon the expiration of the ten-year period, a taxpayer may withdraw from the water's edge election. Such withdrawal must be made in writing within one year of the expiration of the election, and is binding for a ten-year period, subject to the same conditions as applied to the original election. If no withdrawal is properly made, the water's edge election shall be in place for an additional ten-year period, subject to the same conditions as applied to the original election.

(f) The provisions of this section shall apply to all taxpayers other than unitary groups of financial institutions.

(g) Any taxpayer required under this section to file a combined report shall compute the tax owed under this section and under the provisions of this part without reference to this section. The tax owed shall be the greater of the two (2) amounts so computed.

SECTION 2. Tennessee Code Annotated, Section 67-6-228(a), is amended by deleting the subsection in its entirety and by substituting instead the following:

(a)

(1) Notwithstanding any provision of this part to the contrary, except as otherwise provided in subsection (b), the retail sale of food and food ingredients for human consumption shall be taxed at the rate of three and one half percent (3.5%) of the sales price.

(2) Notwithstanding the provisions of any law to the contrary, the commissioner, based upon reporting of sales and any other data or information the commissioner deems relevant, shall substantially reimburse counties and municipalities for the loss of state-shared taxes directly resulting from the

decrease in the tax rate from five and one half percent (5.5%) to three and one half percent (3.5%).

SECTION 3. Tennessee Code Annotated, Section 67-6-103(c)(2), is amended by deleting the language " six percent (6%)" and substituting instead the language "five and one half percent (5.5%)".

SECTION 4. The commissioner is authorized to promulgate rules and regulations to effectuate the purposes of this act. All such rules and regulations shall be promulgated in accordance with the provisions of Tennessee Code Annotated, Title 4, Chapter 5.

SECTION 5. For the purposes of promulgating rules and regulations, this act shall take effect upon becoming a law, the public welfare requiring it. For all other purposes, this act shall take effect January 1, 2009, the public welfare requiring it, and shall apply to tax years commencing on or after that date.